

Message Text

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TOAGS: ECON, XM, CO

SUBJ: ECONOMIC ALERT REPORT (CERP 0003)

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SUMMARY

THE COLOMBIAN ECONOMY FACES NO SIGNIFICANT ECONOMIC PROBLEMS OVER THE NEXT 12 MONTHS THAT ARE LIKELY TO REQUIRE A U.S. POLICY RESPONSE. WHILE THE COLOMBIAN ECONOMY CONFRONTS SERIOUS SHORT TERM PROBLEMS OF INFLATION AND ECONOMIC MANAGEMENT, THESE SHOULD NOT IMMEDIATELY NOR DIRECTLY AFFECT U.S. INTERESTS TO ANY SIGNIFICANT DEGREE. HOWEVER, THERE IS A RISK THAT, OVER THE MEDIUM TERM, GRADUAL DETERIORATION OF THE COLOMBIAN ECONOMY RESULTING FROM CREDIT AND EXCHANGE RATE POLICIES COULD LEAD TO STRUCTURAL BALANCE OF PAYMENTS PROBLEMS, INCREASED UNEMPLOYMENT, DETERIORATION OF INCOME DISTRIBUTION AND CONSEQUENT POLITICAL TURMOIL. BILATERAL TRADE ISSUES ARE NOT EXPECTED TO BECOME MORE NUMEROUS (ALTHOUGH THERE COULD BE COUNTERVAILING DUTY PROBLEMS) BUT IN THE MEDIUM TERM THEY COULD BECOME MORE SENSITIVE. WE MUST ALSO BE ALERT TO THE RISK OF THE SPREAD OF COFFEE RUST TO COLOMBIA WHICH COULD PRESENT A SITUATION

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IN WHICH THE U.S. WOULD WANT TO CONSIDER SOME KIND OF EMERGENCY RELIEF.

ECONOMIC PROBLEMS AND CRITICAL POINTS

1. INFLATION IS COLOMBIA'S PRINCIPAL ECONOMIC PROBLEM AND WILL REMAIN SO OVER THE NEXT 12 MONTHS. FROM A HISTORICAL AVERAGE RATE OF 10 PERCENT FROM 1952

TO 1972, THE AVERAGE INFLATION RATE FROM 1972 THROUGH 1976 ROSE TO 25 PERCENT, AND IN 1977 IT WILL REACH A HISTORICAL HIGH OF BETWEEN 36 AND 39 PERCENT. THE ESSENTIAL ECONOMIC PROBLEM WITH THESE RATES OF INFLATION (SEE BOGOTA 3928) IS THAT, GIVEN THEIR ROOT CAUSES (SEE A-154 1976), THE MAINTENANCE OF A PROPER PRICE FOR CREDIT AND THE PESO IS VERY DIFFICULT. NEGATIVE REAL INTEREST RATES WILL FURTHER INCREASE CAPITAL SCARCITY AND DISTORT INVESTMENT, EXACERBATE INCOME DISTRIBUTION PROBLEMS, AND CONCENTRATE CREDIT (SEE A-60). AN INAPPROPRIATELY PRICED PESO WILL INCREASE DEPENDENCE ON COFFEE AND REVERSE THE LAST TEN YEARS STRUCTURAL ECONOMIC PROGRESS (SEE BOGOTA 4196 AND 5931). WITH 1.6 BILLION DOLLARS IN INTERNATIONAL RESERVES, AND HIGH COFFEE PRICES, AN OVER-VALUED PESO DOES NOT POSE AN IMMEDIATE BALANCE OF PAYMENTS PROBLEM NOR WILL IT IN THE NEXT TWELVE MONTHS. HOWEVER, WITH HIGH INFLATION AND NEAR ZERO DEVALUATION, COLOMBIAN MINOR EXPORTS ARE BEING PRICED OUT OF WORLD MARKETS. SO FAR IN 1977, MINOR EXPORTS ARE STILL GROWING IN VALUE RELATIVE TO 1976, BUT IN TONNAGE THEY HAVE DECLINED BY 9 PERCENT. MORE IMPORTANTLY, EXPORTS OF MANUFACTURES HAVE DECLINED BY 14 PERCENT IN VALUE COMPARING MED-YEAR 1977 WITH MED-YEAR 1976. ECONOMIC GROWTH, EMPLOYMENT, URBAN IMMIGRATION, INCOME DISTRIBUTION AND POLITICAL AND ECONOMIC DIVERSIFICATION ARE ALL RELATED TO MINOR EXPORT GROWTH.

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2. SINCE THE PRIMARY FOCUS OF THE LOPEZ ADMINISTRATION HAS BEEN PRICE STABILIZATION, GOVERNMENT PROGRAMS TO IMPROVE INCOME DISTRIBUTION AND EXPAND NEEDED INFRASTRUCTURE HAVE SUFFERED. HOWEVER, THE ADMINISTRATION HAS FAILED TO RESTRAIN INFLATION, SO THAT, IN ORDER TO HAVE SOMETHING TO SHOW, IT WILL PUSH INVESTMENT STRONGLY FOR THE REMAINDER OF THE TERM, AND INCREASE ITS FOREIGN INDEBTEDNESS. SINCE COLOMBIA ENJOYS A RELATIVELY LOW RATIO OF EXTERNAL DEBT TO EXPORTS AND SINCE ITS RESERVES ARE FLUSH, INTERNATIONAL LENDERS ARE ANXIOUS TO INCREASE LOANS TO COLOMBIA WITHOUT PAYING SUFFICIENT ATTENTION TO THE LONG TERM EFFECTS OF THIS LENDING, AND HENCE ARE CONTRIBUTING TO SOME OF THE UNDERLYING PROBLEMS (SEE BOGOTA 5931). CONCOMITANTLY, SINCE RESERVES ARE LIKELY TO CONTINUE TO GROW OVER THE NEAR TERM, AND INFLATION TO REMAIN A PROBLEM, THE MONETARY AUTHORITIES WILL NOT RENEW AN APPROPRIATE RATE OF DEVALUATION. A MODEST DEVALUATION AND PERHAPS AN INCREASE IN EXPORT SUBSIDIES IS MORE LIKELY, WITH THE LATTER RAISING COUNTERVAILING DUTY PROBLEMS. AN EXPORT SUBSIDY OF SUFFICIENT MAGNITUDE TO MAINTAIN A REAL EFFECTIVE EXCHANGE RATE APPROPRIATE FOR MINOR

EXPORT GROWTH IS HIGHLY UNLIKELY, HOWEVER, AND THE COMPETITIVENESS OF COLOMBIAN NON-COFFEE EXPORTS WILL CONTINUE TO ERODE. SUCH A POLICY MAKES THE ECONOMY HIGHLY VULNERABLE TO A SHARP DROP IN COFFEE PRICES OR, A SERIOUS DROP IN COFFEE EXPORTS SHOULD THERE BE A COFFEE RUST. BALANCE OF PAYMENTS PROBLEMS MAY MAKE COLOMBIA'S AUTHORITIES LESS WILLING TO CARRY ON A VIGOROUS BATTLE AGAINST NARCOTIC DRUGS (SEE A-15).

3. WITH A DETERIORATION OF COLOMBIAN COMPETITIVENESS IN MANUFACTURES, BILATERAL TRADE PROBLEMS MAY BECOME LESS NUMEROUS, BUT THEY WILL BE FAR MORE INTENSE. FOR EXAMPLE, IN CATEGORIES OF THE TEXTILE QUOTA (UP FOR RENEWAL IN 1978) WHERE COLOMBIA REMAINS COMPETITIVE, INFLEXIBILITY LIMITED OFFICIAL USE

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ON OUR PART WILL BE VIEWED EVEN MORE SERIOUSLY THAN IN THE RECENT PAST BECAUSE COLOMBIA WILL HAVE A GREATER NEED FOR THOSE EXPORTS.

THE NEXT TWELVE MONTHS

4. AGRICULTURAL OUTPUT, SPURRED BY HIGH PRICES AND GOOD WEATHER, AND MANUFACTURING, RESPONDING TO STRONG INTERNAL DEMAND, WILL LEAD REAL GDP OVER THE NEXT TWELVE MONTHS TO 7 TO 8 PERCENT ANNUAL RATES OF GROWTH. INFLATION WILL DECLINE, BUT IT IS DIFFICULT TO PREDICT BY HOW MUCH UNTIL MONETARY EXPANSION FOR THE LAST QUARTER OF 1977 IS KNOWN. DURING THESE MONTHS THE MONEY SUPPLY HISTORICALLY EXPANDS RAPIDLY. IF THE ADMINISTRATION CAN HOLD THE MONETARY LINE THIS YEAR, INFLATION OVER THE NEXT 12 MONTHS COULD BE DRIVEN DOWN TO THE LOW 20'S OR EVEN LESS. IF THEY SLIP AGAIN HOWEVER, AND SOME SLIPPAGE IS HIGHLY LIKELY, INFLATION WILL BE HIGHER. RESERVES WILL CONTINUE TO GROW OVER THE NEXT TWELVE MONTHS REACHING 2 TO 2.5 BILLION DOLLARS. MINOR EXPORTS WILL GROWN IF THE WEATHER REMAINS FAVORABLE, BUT THE TREND IS FOR SLUGGISH OR NEGATIVE GROWTH IN MINOR EXPORTS AND CONTINUED NEGATIVE GROWTH OF MANUFACTURING EXPORTS. THE NEXT TWELVE MONTHS WILL SEE A FLURRY OF ACTIVITY TO GET INFRASTRUCTURE AND ENERGY PROJECTS MOVING, INCLUDING LARGE FOREIGN INVESTMENTS IN COAL AND NICKEL.
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